THE INSURANCE DEPARTMENT OF THE STATE OF DELAWARE

IN THE MATTER OF:

The Proposed Acquisition of Royal Indemnity Company, a Delaware domiciled property/casualty insurance company, Security Insurance Company of Hartford, a Delaware Domiciled property/casualty insurance company, Guaranty National Insurance Company, a Delaware domiciled property/casualty insurance Company, and Royal Surplus Lines Insurance Company, a Delaware domiciled property/casualty insurance company, by Arrowpoint Capital Corp., a Delaware Corporation, and Arrowpoint Capital, LLC, a Delaware limited liability company	)	Docket No. 313

ORDER ON PRE-HEARING MOTIONS

1. This proceeding involves a proposed transaction (the "Royal US Acquisition") in which Arrowpoint Capital Corp. and Arrowpoint Capital LLC (the "Applicants") would acquire the partnership interests in Arrowpoint General Partnership (the "Partnership"). The Partnership owns 100% of the common stock of Royal & SunAlliance USA, Inc. ("RSA USA"), which in turn indirectly owns 100% of the common stock of four Delaware domestic insurers (the "Insurers"), including Royal Indemnity Corporation ("Royal Indemnity"). As a result, the Royal US Acquisition requires the approval of the Commissioner of Insurance of the State of Delaware (the "Commissioner") pursuant to 18 *Del.C.* §5003 ("Section 5003").

2. Current directors, officers and certain employees of RSA USA are the beneficial owners of the Applicants. The proposed Royal US Acquisition, in substance, would result in the transfer of ownership and control of the Insurers from The Royal & Sun Alliance Insurance Group plc ("RSA plc") to the Applicants.

3. In proceedings in this matter prior to the appointment of the undersigned as Hearing Officer, various persons (identified collectively as "the Moving Policyholders") who assert significant claims or potential claims as holders of insurance policies issued by the Insurers submitted a variety of requests for pre-hearing relief. Specifically:

a. The following Moving Policyholders seek to be accorded the status of formal parties to this proceeding (a number of these persons have also explicitly sought leave to take discovery, and such requests will be treated as ancillary to, and subsumed within, their applications for status as parties): General Motors Corporation ("GM"); DaimlerChrysler Corporation ("DC"); The Student Loan Corporation ("SLC"); Federal-Mogul Corporation ("F-M"); MBIA Insurance Corporation ("MBIA"); Wells Fargo Bank, as trustee ("WF"); World

Trade Center Properties, LLC, Silverstein Properties Inc., Silverstein WTC Mgmgt. Co. LLC 2, 2 World Trade Center LLC, 4 World Trade Center LLC, and 5 World Trade Center LLC (collectively "WTC"); The Port Authority of New York and New Jersey and 1 World Trade Center LLC (collectively "Port Authority"); and Westfield WTC LLC, Westfield WTC Holding LLC, Westfield Corporation Inc. and Westfield America, Inc. (collectively "Westfield").

b. Several Moving Policyholders (GM, DC, SLC, MBIA, WF, Port Authority and Westfield) seek continuance of the hearing in this matter in order to permit discovery on matters asserted to be related to the issues in this proceeding. In particular, GM seeks a continuance of 120 days from the time of completion of the Form A filing in this matter, in significant part for the purpose of having this proceeding informed by the disposition of certain of the issues in its litigation against Royal Indemnity in the Circuit Court of Oakland County, Michigan (the "Michigan litigation").

c. WTC has also moved for the appointment of an independent actuary for the purpose of evaluating whether the Insurers have adequately reserved for the claims (pending and potential) against them. WTC has also sought leave to submit the Declaration of Prof. David F. Babbel and Hon. Robert E. Wilcox, MAAA (the "Babbel/Wilcox Declaration").

4. The Moving Policyholders have submitted an array of speaking motions and letter memoranda in support of their various applications, and the Applicants and the Delaware Department of Insurance ("DID") have responded in kind. Counsel for these participants submitted additional oral comments on the various applications at a two and a half hour telephonic pre-hearing status conference on December 14, 2006 (the "December 14 Status Conference").

5. The recitation of background and reasons for the determinations embodied in this Order is necessarily truncated and preliminary, and is not intended to set forth final determinations of either fact or law that will control the disposition of the matter upon final public hearing. As recited more formally below, however, and for the reasons recited briefly below, WTC's application for leave to submit the Babbel/Wilcox Declaration is granted, but the other applications of the Moving Policyholders are denied.

6. Not surprisingly in light of the sophistication of their counsel, the Moving Policyholders support their various motions with a superficially compelling array of legal authorities and appeals to practical and policy concerns. Their legal arguments in support of their motions for party status center on Section 5003(d)(2), specifically its provision that in connection with the public hearing on a matter such as this, "any person … whose interest may be affected thereby shall have the right to present evidence, examine and cross-examine witnesses, and offer oral and written arguments and in connection therewith shall be entitled to conduct discovery proceedings in the same manner as is presently allowed in the Superior Court of this State." Because of their status as holders of policies issued by the Insurers (policies that involve upwards of hundreds of millions of dollars), the Moving Policyholders maintain that they have an "interest" that "may be affected" by this proceeding, and they therefore have a statutory right to "conduct discovery proceedings" and "present evidence, examine and cross-examine witnesses" as if this were an action pending in the Superior Court.

7. This statutory argument does not adequately take into account competing statutory provisions and objectives:

a. Section 5003(d)(2) also requires that the public hearing "be held within 30 days after the [Form A] is filed," and that the hearing occur upon as little as "7 days' notice to such other persons [other than "the person filing the statement"] as may be designated by the Commissioner." The statute does not clearly explain how the Commissioner could satisfy the 30-day hearing deadline and still afford persons with an "interest" in the matter the right to take discovery as under the Rules of the Superior Court. What is clear, however, is that Section 5003 contemplates a relatively expedited proceeding for action on applications for approval of a change of control of a Delaware domestic insurer. An expansive view of this sort of proceeding as an adversarial forum equivalent to ordinary civil litigation undermines that clear statutory policy of expedition. This consideration militates against allowing intervention in this proceeding on a basis that is more liberal than the standard generally applicable to intervention in civil actions in the Superior Court (*see* Superior Court Civil Rule 24(a)(2), denying intervention as of right if the applicant's interest is adequately represented by existing parties).

b. The term "interest" as used in Section 5003(d)(2) is not defined by statute or case law, and is by no means self-defining. It should therefore be construed in a manner consistent with the governing statutory objectives and regulatory framework. All agree that the protection of policyholders is the paramount objective of Delaware's body of insurance regulation. And with regard to the regulatory framework, it is clear that "[i]n Delaware, as in most states, the Insurance Commissioner is charged with the responsibility of providing [ ] scrutiny and assessing risk to Delaware policyholders by enforcing the laws and regulations with their best interests in mind." *In the Matter of Proposed Affiliation of BCBSD, Inc.*, 2004 Del. Super. LEXIS 333, *53 (Oct. 4, 2004). The protection of policyholders is thus the primary function of the Commissioner. The statutes do not place responsibility for protecting policyholders in the realm of private enforcement through litigation or an equivalent process. Therefore, in the absence of substantial evidence that the Commissioner – through his general investigative and supervisory powers, and through the conduct of this hearing process – is incapable of discharging his statutory obligation to review change of control transactions to determine whether they "prejudice the interest of [ ] policyholders" (Section 5003(d)(3)(c)), some distinct, substantial interest beyond that as a policyholder should be required as a basis for entitlement to party status in proceedings under Section 5003. However significant their interests as policyholders may be, none of the Moving Policyholders has articulated and demonstrated such a distinct "interest" of the sort that would justify their intervention as parties in this matter.

8. With regard to practical and policy concerns, however, the Moving Policyholders urge that the proposed Royal US Acquisition is a conflict transaction (in light of the equity interest of current management in the acquiring entities), and therefore requires regulatory oversight in a manner that cannot be, and is not being, applied by the DID in this matter. In essence, the Moving Policyholders maintain that regulatory oversight will be deficient as a matter of law in the absence of an adversarial process (involving discovery and cross-examination, as in litigation) or at least some independent alternative (such as the appointment of

an independent actuary) to test the adequacy of the proposed Royal US Acquisition from the perspective of protecting the Insurers' policyholders.

9. The Moving Policyholders, however, have not demonstrated (at least at this point) that the Commissioner and this proceeding are incapable of protecting the policyholders' interests in the absence of their intervention and conduct of adversarial proceedings in this matter:

a. Preliminarily, the Moving Policyholders have not demonstrated that the proposed Royal US Acquisition is tainted by unique or unusual conflicts of interest. In conflict transactions generally, the primary concern is that directors and officers will use their control to structure a transaction to favor themselves at the expense of their corporation and its stockholders. In view of that sort of concern, the party meriting protection here would be RSA plc, the seller in the transaction. There is no substantiated conflict, however, between RSA's directors and officers, on one hand, and the Insurers' policyholders, on the other: to the contrary, it is at least equally plausible that the directors and officers would be anxious to extract as much from RSA plc as possible in the proposed transaction for the benefit of the Insurers (and, indirectly, for the benefit of their policyholders), since the more financially secure the Insurers become under the transaction, the more profit and job security the directors and officers might be able to achieve in the long run. To be sure, WTC suggests that management of the Insurers (like any equity holder of a domestic insurer) will have an incentive to minimize payouts to policyholders, unmitigated by any countervailing reputational incentive to promote the writing of additional policies. While that suggested incentive may be one that should be taken into account in evaluating the proposed Royal US Acquisition at the public hearing in this matter, it is not one that is sufficiently concrete at this stage to require a determination that the DID is incapable of effectively representing policyholder interests in evaluating the proposed transaction (even without the proposed transaction, and while under the ultimate control of RSA plc, the Insurers already seem to have had no lack of zeal to minimize claims brought by GM, DC, MBIA and WTC).

b. The Moving Policyholders question the efficacy of the DID's review of the proposed Royal US Acquisition, asserting that in evaluating the Insurers' financial condition and reserves, the DID has not directly contacted any of the Moving Policyholders to obtain their input in assessing the appropriate amounts to reserve on claims that they assert. The Moving Policyholders, however, point to nothing in any statute, rule or case precedent that requires that the DID's assessment of the Insurers' reserves must include an invitation to claimants to present evidence and argument concerning their respective claims.

c. The Commissioner's powers with respect to this proceeding, moreover, by no means exhaust his authority to protect policyholder interests. GM expresses particular concern, for example, that the proposed Royal US Acquisition would grant "management insiders the opportunity to extract millions of dollars from the acquired companies to the detriment of the policyholders." (Docket #15 at 3). Even disregarding the limitations on distributions by the Insurers established in the proposed Royal US Acquisition, however, GM's stated concern is significantly addressed by statutes that would require the Insurers to give notice to the DID of proposals to declare and pay dividends to the Insurers' owners (*see*18 *Del. C.* §5004(e),

§5005(b)), and that require the DID to periodically examine the financial condition of domestic insurers (*see* 18 *Del. C.* §§318 *et seq.*).

10. Denial of the Moving Policyholders' applications for party status does not deny them a meaningful opportunity to call attention to their concerns about the proposed Royal US Acquisition. They have not squarely contended that such denial would unconstitutionally deprive them of due process of law, and any such contention would lack merit. *See LaFarge v. Cmwlth. of Pa., Ins. Dep't.*, 735 A.2d 74, 78 (Pa. 1999) (in proceeding on insurer's proposal to place asbestos and environmental liabilities in a separate operating entity, notice and opportunity to comment "were adequate to satisfy the requirements of due process," and the "imposition of additional procedures such as sworn testimony, cross-examination, a full stenographic record, and opportunity to submit briefs would entail extensive delay [and] would not materially enhance the interests of [policyholders]"). In this proceeding, the Moving Policyholders have had and will have significant opportunities to present their concerns. They have already submitted comments that will surely need to be addressed in connection with the public hearing in this matter. The Babbel/Wilcox Declaration, for example, raises a number of significant questions (*e.g.*, about the scope of and responsibility for unfunded pension obligations) that the Applicants and the DID should address in regard to the statutorily required evaluation of the effect of the proposed transaction on the Applicants' financial condition and the Insurers' financial stability. It can be expected that the Moving Policyholders will submit still more comments on the proposed transaction, and those comments should inform the outcome of this proceeding.

11. The Moving Policyholders' requests for continuance become largely moot once it is determined that they will not have party status in this matter and therefore will not be entitled to conduct discovery. GM suggests an independent reason, however, why a continuance would be appropriate, so it is necessary to address that reason here. GM's suggestion is that the hearing in this matter should await the outcome of proceedings in the Michigan litigation, since the trial in that litigation, scheduled to begin in February 2007, could soon result in a trial court-level resolution of Royal Indemnity's liability to GM on substantial policy claims, and that the adequacy of the Insurers' reserves would become clearer with the benefit of such a resolution. There are at least two reasons, however, to reject this suggestion as a predicate for an extended continuance here. First, it is not a foregone conclusion that developments in the Michigan litigation will occur as promptly as GM expects: damages issues may be bifurcated and deferred, as Royal Indemnity is seeking, or proceedings may be delayed for any number of other reasons inherent in the litigation process. Second, and more importantly, the previously mentioned statutory policy of expedition counsels against even a limited stay of this administrative proceeding in favor of civil litigation pending elsewhere.

12. With respect to WTC's application for the appointment of an independent actuary, the Applicants raise the threshold question of whether the Hearing Officer in a proceeding of this sort has the statutory authority to require such an appointment. WTC points out that in the proceeding involved in *LaFarge, supra*, the Pennsylvania Insurance Department engaged an independent actuary, and that under Section 5003(d)(3) the Commissioner may retain actuaries "not otherwise part of the Commissioner's staff as may be reasonably necessary to assist the Commissioner in reviewing the proposed acquisition of control." The question of the Hearing

Officer's authority to require the appointment of an independent actuary may be academic in any event, since WTC is surely correct in asserting, alternatively, that the Hearing Officer could at least recommend that the Commissioner appoint an independent actuary. For reasons previously set forth, however, the application for an order requiring or recommending the appointment of an independent actuary will be denied. Any lack of a report by such an actuary may be taken into account in evaluating the application for approval of the proposed Royal US Acquisition. In the meantime, however, there is no factual basis for a determination at this stage of the proceedings that the DID's evaluation to date suffers from some debilitating disqualification or inadequacy (see paragraph 7b, above).

13. For similar reasons, it is inappropriate to enter any direction to the Applicants or to the DID with respect to the content of the Applicants' Form A filing in this matter. The determination of the completeness of that filing is the responsibility of the DID. Whether that filing is a sufficient basis for approval of the proposed Royal US Acquisition is a different question, one that is to be addressed at the public hearing in this proceeding.

IN CONSIDERATION OF WHICH,

A. WTC's motion for leave to submit the Babbel/Wilcox Declaration is **granted**;

B. The various motions for party status, for discovery, for continuance and for appointment of an independent actuary are **denied**;

C. Notwithstanding such denial, the materials previously submitted by the Moving Policyholders, including the Babbel/Wilcox Declaration, will be considered as written comments on the proposed Royal US Acquisition, and such materials need not be resubmitted for purposes of such consideration, and the Moving Policyholders may submit additional written comment and argument in accordance with procedures to be established for the public hearing in this matter.

/s/ Lawrence A. Hamermesh
Prof. Lawrence A. Hamermesh
Hearing Officer

December 20, 2006